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AN ANALYSIS OF THE CURRENT SERVICES BUDGET CONTAINED IN THE PRESIDENT'S BUDGET FOR FISCAL YEAR 1989

SUBMITTED TO

THE SENATE AND HOUSE COMMITTEES ON THE BUDGET

PREPARED BY THE STAFF OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

IN ACCORDANCE WITH THE CONGRESSIONAL BUDGET AND IMPOUNDMENT CONTROL ACT OF 1974, AS AMENDED (31 U.S.C. 1109(b))

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AN ANALYSIS OF THE CURRENT SERVICES BUDGET CONTAINED IN THE PRESIDENT'S BUDGET FOR FISCAL YEAR 1989 [1]

The Congressional Budget and Impoundment Control Act of 1974, as amended, requires the President to submit a current services budget to Congress. This budget, published as a part of Special Analysis A in the Special Analyses, Budget of the United States Government, is intended to present the level of outlays and budget authority "for the following fiscal year if programs and activities of the United States Government were carried on during that year at the same level as the current fiscal year without a change in policy." Such benchmark estimates and the corresponding current services receipts estimates are to be accompanied by "the economic and program assumptions on which those budget outlays are based, including inflation, real economic growth, and unemployment rates, program caseloads, and pay increases." The Budget Act also requires the Joint Economic Committee to review the estimated budget outlays and proposed budget authority and submit an evaluation to the Committees on the Budget of both Houses.

The Economic Forecast Underlying the Current Services Budget

The Administration's economic forecast plays a crucial role in determining the current services budget. Future economic conditions significantly affect budget estimates because of their effects on tax receipts, unemployment benefits, interest on the Federal debt, and other programs under which spending varies with the unemployment, interest, or inflation rates.

The 1989 current services budget, prepared by the Office of Management and Budget (OMB), indicates that no changes in current fiscal policies are necessary in order to assure steady reduction of the budget deficit to 0.6 percent of GNP by 1993. This would be the lowest percentage since 1974; it would also be one-tenth of the postwar peak of 6.3 percent in 1983, and well below the 1971–87 average of 3.1 percent.

This view of the likely course of the budget deficit under current policies differs markedly from the projections of other economic forecasters. For example, the baseline budget projections by the Congressional Budget Office (CBO), similar in concept to the Administration's current services budget, indicate that in the absence of any changes in fiscal policy, the deficit would decline somewhat by 1993, both in nominal terms and as a percentage of GNP, but that it would remain high by historical standards. These two estimates are compared in Table 1.

[1] All years referred to are fiscal years, unless otherwise indicated.

TABLE 1.—ADMINISTRATION'S CURRENT SERVICES DEFICIT AND CBO'S BASELINE BUDGET DEFICIT, IN BILLIONS OF CURRENT DOLLARS AND AS A PERCENTAGE OF GNP, 1963–93

Fiscal year	Administration's current services deficit		CBO's baseline budget deficit	
	In current dollars	Percent of GNP	In current dollars	Percent of GNP
Average, 1963–82	34	1.9	34	1.9
1983	208	6.3	208	6.3
1984	185	5.0	185	5.0
1985	212	5.4	212	5.4
1986	221	5.3	221	5.3
1987	150	3.4	150	3.4
1988	148	3.1	157	3.4
1989	139	2.8	176	3.5
1990	111	2.1	167	3.1
1991	86	1.5	158	2.8
1992	63	1.0	151	2.5
1993	39	0.6	134	2.1

There are a number of programmatic differences between OMB's current services budget and CBO's baseline budget. The paramount reason for their divergent views concerning the future course of the budget deficit under current policy is their differences concerning the most likely path for the economy over the next 6 years.

The differences in key elements of the OMB and CBO forecasts are shown in Table 2. OMB is more optimistic than CBO in every respect, predicting faster growth, a lower unemployment rate, less inflation, and lower interest rates. OMB's expectation that growth will average 0.6 percentage point more than CBO's estimate reflects greater optimism at OMB about the prospects for job growth, and also apparently a higher forecast of the productivity growth rate over the next 6 years. OMB's lower estimates for the unemployment rate are due to their more optimistic view about economic growth.

TABLE 2.—ECONOMIC FORECASTS MADE BY OMB AND CBO, CALENDAR YEARS 1988–93

[In percent]

Year	Real GNP growth rate		Civilian unemployment rate[1]		Percent change, Consumer Price Index		Interest rate, 3-month Treasury bills	
	OMB	CBO	OMB	CBO	OMB	CBO	OMB	CBO
1988	2.9	2.3	5.9	6.2	4.3	4.5	5.3	6.2
1989	3.1	2.6	5.7	6.1	4.1	4.9	5.2	6.7
1990	3.5	2.6	5.5	6.0	3.6	4.6	5.0	6.6
1991	3.4	2.6	5.4	5.9	3.2	4.4	4.5	6.4
1992	3.3	2.7	5.3	5.9	2.7	4.4	4.0	6.1
1993	3.2	2.7	5.3	5.8	2.2	4.4	3.5	5.9
Average	3.2	2.6	5.5	6.0	3.3	4.5	4.6	6.3

[1] OMB predicts the total unemployment rate, including the armed forces residing in the United States. Their forecasts have been raised by 0.1 percentage point to obtain an estimate of the civilian unemployment rate.

The Administration foresees a steady drop in the rate of inflation, to 2.2 percent by 1993, while CBO predicts that inflation will stabilize at about 4.5 percent per year. The Administration also

predicts a steady drop in interest rates, while CBO believes that rates will stabilize near present levels. OMB's view on the likelihood of combining solid growth with steadily falling inflation and interest rates seem very optimistic.

The views of many private forecasters are consistently closer to those of CBO's than to OMB's. For example, over the 1988–93 period Data Resources, Inc., and Wharton Econometics predict, respectively, real GNP growth averaging 2.4 percent and 2.6 percent; a civilian unemployment rate averaging 5.5 percent and 6.0 percent; and average increase in the Consumer Price Index of 4.8 percent and 4.3 percent; and average rates for 3-month Treasury bills of 6.0 percent and 6.7 percent.

An indication of the impact of different economic assumptions on the budget deficit is provided by the "rules of thumb" presented by OMB in the 1989 budget. For example:

(1) If the economy grows at an annual rate 1 percent lower than forecast in each of the fiscal years from 1989 through 1993, and this is reflected in a higher unemployment rate (rather than, say, a lower rate of productivity growth), the budget deficit would be $7.7 billion larger in 1989; this gap would rise steadily, reaching $76.7 billion by 1993.

(2) If interest rates are 1 percent higher in each of the fiscal years from 1989 through 1993, and inflation persists at the predicted rate of 3.3 percent, the budget deficit would be $5.2 billion higher in 1989; this gap would also increase steadily, reaching $20 billion by 1993.

The Current Services Budget for Defense

Prior to the 1984 budget, submitted in January 1983, current services estimates for defense were based on the previous year's appropriation level adjusted for inflation only; the estimates for defense, as in other areas, did not include real growth. As discussed in detail in last year's Joint Economic Committee analysis of the current services budget, for fiscal years 1984 through 1988 this approach was not followed, and the defense current services estimates included an allowance for real growth.

In the budgets for fiscal year 1984 through fiscal year 1987, it appeared that the Administration was proposing to reduce defense spending below the current services levels. Last year the current services estimates for defense were arbitrarily set equal to the Administration's proposal, suggesting that no change from the current services levels was being proposed. As the General Accounting Office stated in a December 1986 report to the Joint Economic Committee, these practices "can result in a current services budget developed to support the President's proposed policies rather than to highlight the fiscal effects of proposed policy changes," and, as a result, OMB's "use of different policy definitions for different programs lessens the usefulness of the current services budget as a budget tool." [2]

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[2] "The President's Current Services Budget," Report to the Chairman, Joint Economic Committee, GAO Report AFMD–87–10, Dec. 2, 1986.

Unfortunately, this year OMB has followed last year's practice and set the current services budget for defense equal to the Administration's proposal. This may be justified for 1989, since the President's request is based on the Bipartisan Budget Agreement as stated in the Omnibus Budget Reconciliation Act (OBRA) of 1987, but it is a highly questionable assumption when applied to later years. For 1990 through 1993, the President's request and OMB's current services estimates for the national defense function both include 2 percent real growth per year. A better procedure would be to follow the methods used in the rest of the current services budget, which generally assume no real growth in budget authority. An alternative baseline, based on the latter approach, is shown in Table 3. This yields the following current services estimates of outlays for the defense function: $300.3 billion for 1990, $5.9 billion below OMB's estimate; $307.9 billion for 1991, $12.3 billion below OMB's estimate; $316.1 billion for 1992, $19.3 billion below OMB's estimate; and $324.6 billion for 1993, $26.7 billion below OMB's estimate.

TABLE 3.—ALTERNATIVE CURRENT SERVICES ESTIMATES OF BUDGET AUTHORITY (BA) AND OUTLAYS (O) FOR THE NATIONAL DEFENSE FUNCTION, IN BILLIONS OF DOLLARS, 1988–93 [1]

Fiscal year	Admin. proposal and current services estimates			Change in BA price deflator: 1990–93 [2] percent	Alternate current services estimates [3]	
	BA	O	O/BA		BA	O
1988	291.4	285.4	0.979	([4])	291.4	285.4
1989	299.5	294	.981	([4])	299.5	294
1990	316.4	306.2	.968	3.57	310.2	300.3
1991	333.7	320.2	.960	3.40	320.7	307.9
1992	351.6	335.4	.954	3.30	331.3	316.1
1993	370.2	351.3	.949	3.23	342	324.6

[1] The national defense function (budget functional code 050) includes Department of Defense-Military, atomic energy defense activities, and other defense-related activities.

[2] Obtained by dividing BA for the fiscal year by BA for the preceding fiscal year, and dividing the result by 1.02, to remove the administration's proposed 2 percent real growth.

[3] For 1988 and 1989, same as administration proposal and current services estimates. For 1990–93, BA obtained by increasing the BA for the previous year by the change in the price deflator given in the preceding column, and O obtained by multiplying BA by the O/BA ratio from the third column.

[4] Not applicable.

These alternative estimates of the current services baseline for defense outlays put the Administration's proposals for 1990–93 in a very different light (Table 4). Instead of a total cut in outlays of $5.9 billion in 1990, the alternative baseline shows no cut in total outlays. Instead of cuts in total outlays of $5.6 billion in 1991, $10.9 billion in 1992, and $14.9 billion in 1993, the alternative baseline indicates that the Administration has proposed increases in total outlays in these 3 years of $6.7 billion, $8.4 billion, and $11.8 billion. For these 4 fiscal years as a whole, OMB's baseline suggests that the Administration has proposed cuts in total outlays of $37.3 billion; the alternative baseline shows the Administration has actually proposed increases in total outlays of $26.9 billion—a net difference of $64.2 billion.

TABLE 4.—PROPOSED CHANGES IN OUTLAYS UNDER TWO DIFFERENT CURRENT SERVICES BASELINES FOR DEFENSE, IN BILLIONS OF DOLLARS, 1990–93

Fiscal year	Proposed change from OMB baseline			Proposed change from alternative baseline		
	Defense	Nondefense	Total	Defense	Nondefense	Total
1990	$0	−$5.9	−$5.9	+$5.9	−$5.9	$0.0
1991	0	−5.6	−5.6	+12.3	−5.6	+6.7
1992	0	−10.9	−10.9	+19.3	−10.9	+8.4
1993	0	−14.9	−14.9	+26.7	−14.9	+11.8
Total	0	−37.3	−37.3	+64.2	−37.3	+26.9

The Current Services Budget for Areas Other Than Defense

With regard to the pay raise for Federal civilian employees in 1989 and subsequent years, OMB states that "For 1989, the civilian agency pay raise is assumed to be 2 percent, as agreed to by the bipartisan budget negotiators. . . . For 1990 and beyond, the civilian agency pay raise is assumed to equal the inflation rate as measured by the gross national product deflator." Thus, in both the President's budget and the current services budget, the civilian pay raise in 1989 would be less than the rate of inflation, and the raises in 1990–93 would be equal to the rate of inflation. Overall, therefore, real Federal civilian pay would decrease.

In its comments on the December 1986 report on the current services budget by the General Accounting Office, OMB stated that, "A pay raise equal to the average private sector pay increase is included in the allowances function, thus incorporating wage inflation." The Administration has not explicitly forecast the increase in private sector pay, but presumably it expects this to be greater than the increase in the cost of living. Use of an appropriate baseline would show that the Administration has proposed to reduce Federal civilian pay over the 1989–93 period, not maintain it at the current services levels.

With this exception, the Administration's procedures in the nondefense areas of the current services budget appear acceptable. It is unfortunate that misleading estimates are still being presented for the current services budget for defense, which affects the accuracy of the budget totals, as well as the defense-nondefense breakdown.

Summary and Conclusions

In their December 1986 report, the General Accounting Office concluded that because of the distortions introduced by OMB, especially in the defense area, Congress should either amend the Budget Act to tighten up the definition of current services or, alternatively, eliminate the current services budget altogether.

The Joint Economic Committee believes that there is a third option. The Administration has developed detailed guidelines for the preparation of the current services budget in OMB's Circular A–11. The main problem has been, and continues to be, that in some cases these guidelines have been ignored, especially in the area of defense. Thus, even in the absence of further Congressional

action to tighten the definition of current services, considerable progress could be made if the Administration simply followed OMB's guidelines more closely, especially with regard to the defense budget. Otherwise the current services budget, which was intended to be a baseline for the clarification of budgetary proposals, will continue to be a source of confusion.

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